

Message Text

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ACTION EUR-12

INFO OCT-01 ARA-10 ISO-00 SP-02 USIA-06 AID-05 EB-08
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FM AMEMBASSY LISBON
TO SECSTATE WASHDC 4350
INFO AMEMBASSY QUITO

C O N F I D E N T I A L SECTION 1 OF 2 LISBON 0301

PASS TREASURY FOR SYVRUD

E.O. 11652: GDS
TAGS: ECON, PFOR, EFIN, PO
SUBJECT: GOP/IMF NEGOTIATIONS

REF: STATE 309075

BEGIN SUMMARY: EMBASSY APPRECIATES COMMENTARY PROVIDED REFTEL.
WE CONCUR THAT USG SHOULD ADOPT NEUTRAL POSITION TOWARD GOP/IMF
NEGOTIATIONS, ALWAYS KEEPING FIRMLY IN MIND THAT FINAL IMF
AGREEMENT MUST BE BOTH ECONOMICALLY SOUND AND POLITICALLY
REALISTIC TO BE EFFECTIVE. EMBASSY ANALYSIS OF MAJOR ISSUES
UNDER DISCUSSION DID NOT RELY ON FIXED IMPORT/GNP COEFFICIENTS.
OUR CONCERN STEMMED FROM UNSATISFACTORY STATE OF CURRENT
INDUSTRIAL AND AGRICULTURAL RAW MATERIAL STOCKS AND FROM
BOTTLENECKS IN DOMESTIC SUPPLY. SITUATIONS IN CONSTRUCTION
AND AGRICULTURAL SECTORS ARE PARTICULARLY TROUBLESOME.
EXPORT PICTURE IS NOT MUCH MORE ENCOURAGING. END SUMMARY.

1. EMBASSY APPRECIATES REFTEL COMMENTARY ON OUR ATTEMPT TO
DESCRIBE SENSITIVITY OF ISSUES UNDER IMF/GOP DISCUSSION,
TO ALERT WASHINGTON AGENCIES TO POSSIBLE FUTURE
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NEGOTIATION TRENDS, AND TO INTERPRET POSSIBLE EFFECTS OF
IMF PROGRAM. WE FULLY CONCUR THAT USG POSITION SHOULD BE
ONE OF NEUTRALITY, LEAVING GOP AND IMF TO NEGOTIATE TECH-
NICAL ASPECTS ON THEIR OWN. ANY AGREEMENT THEY REACH,
HOWEVER, MUST BE BOTH ECONOMICALLY SOUND AND POLITICALLY
REALISTIC IF IT IS TO BE EFFECTIVE. USG ROLE, IF ANY,
SHOULD BE TO ENCOURAGE ADOPTION OF POLICY ALTERNA-

TIVES THAT SATISFY BOTH REQUIREMENTS.

2. EMBASSY CONCURS THAT FIXED RELATIONSHIPS DO NOT EXIST BETWEEN IMPORT AND GNP LEVELS, PARTICULARLY IN A FLUID ECONOMIC SITUATION SUCH AS PORTUGAL'S. WE SUBMITTED BANK OF PORTUGAL IMPORT/GNP COEFFICIENTS SIMPLY TO HIGHLIGHT DIFFICULTIES GOP WOULD FACE IN ATTEMPTING TO REDUCE IMPORTS WHILE SIMULTANEOUSLY PROMOTING GNP GROWTH. COEFFICIENTS WERE NOT MEANT TO BE FIRM GUIDES FOR 1978. EMBASSY ACTUALLY WAS MORE CONCERNED BY SUCH FACTORS AS PRESENT LEVELS OF RAW MATERIAL STOCKS AND BOTTLENECKS IN DOMESTIC SUPPLY.

3. CONTRARY TO WIDESPREAD BELIEFS, NOT ALL SECTORS OR INDUSTRIES AUGMENTED THEIR RAW MATERIAL STOCKS SIGNIFICANTLY IN 1977. MUCH OF THE PUBLIC SECTOR, WHICH CONTROLS VIRTUALLY ALL AGRICULTURAL IMPORTS, HELD ITS INVENTORY PURCHASES TO A MINIMUM. THE PRIVATE SECTOR, ON THE OTHER HAND, INCREASED ITS INVENTORIES IN EARLY AND MID-1977 AS A SPECULATIVE HEDGE AGAINST FURTHER DEVALUATION. BEGINNING IN AUGUST 1977, HOWEVER, MANY FIRMS REDUCED THEIR STOCKS AS THEY FELT THE EFFECTS OF THE GOP'S TIGHTER CREDIT CEILINGS, IMPORT QUOTAS, AND DELAYS IN THE ISSUANCE OF IMPORT LICENSES. (ONE PROMINENT GOP OFFICIAL TOLD US PRIVATELY IN LATE DECEMBER THAT THE IMPORT REQUEST BACKLOG EXCEEDED \$1 BILLION.) IN A SEPTEMBER/OCTOBER SURVEY BY THE PORTUGUESE INDUSTRIAL CONFEDERATION, 71 PERCENT OF THE

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RESPONDING FIRMS CLAIMED THAT THEY WERE EXPERIENCING MEANINGFUL TO SERIOUS DIFFICULTIES IN OBTAINING PRODUCTION INPUTS. OF THE RESPONDING CONSTRUCTION COMPANIES, MORE THAN 90 PERCENT REPORTED SERIOUS SUPPLY PROBLEMS. ALTHOUGH THESE RESPONDERS PROBABLY EXAGGERATED THEIR SITUATION SOMEWHAT, THEIR ANSWERS INDICATE THE GROWING TIGHTNESS OF DOMESTIC SUPPLIES. A MORE RECENT, BRIEF SURVEY BY THE EMBASSY AND THE OPORTO CONSULATE TENDED TO SUPPORT THIS APPRAISAL. OUR SURVEY INDICATED THAT SUCH SECTORS AS RUBBER PRODUCTS, PHARMACEUTICALS, COSMETICS, FOOTWEAR, AND HEAVY CONSTRUCTION EQUIPMENT HAD STOCKS THAT WERE SLIGHTLY TO SIGNIFICANTLY ABOVE NORMAL; OFFICE EQUIPMENT, ELECTRONICS, CHEMICALS, AND SMALL MACHINERY SECTOR STOCKS WERE AT OR ONLY SLIGHTLY BELOW NORMAL LEVELS; HOME APPLIANCE, TEXTILE, AND METALLURGICAL SECTOR STOCKS WERE LOWER THAN NORMAL; AND THE AUTO, LIGHT TRUCK, TRACTOR, AND FEED GRAIN SECTORS WERE CONSIDERABLY BELOW NORMAL. THIS SURVEY SUGGESTED THAT A FEW SECTORS COULD CUT THEIR INVENTORIES SOMEWHAT WITHOUT REDUCING OUTPUT. HOWEVER, A NUMBER OF THEM, SEVERAL OF WHICH ARE AMONG THE PRINCIPAL EXPORT INDUSTRIES (E.G. TEXTILES, METALWORKING), CANNOT REDUCE INVENTORIES WITHOUT

ENDANGERING OUTPUT.

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4. GOP WILL HAVE PARTICULAR DIFFICULTY RESTRICTING IMPORTS OF SEVERAL SECTORS. FIRST, THE CONSTRUCTION SECTOR, WHICH MADE A VERY LARGE CONTRIBUTION TO GNP EXPANSION IN 1977, SUFFERS SEVERE SHORTAGES OF CEMENT, STRUCTURAL STEEL, ELECTRICAL EQUIPMENT, RESINS, LAQUERS, AND CONSTRUCTION BLOCKS. LAST YEAR, THREATS OF PUBLIC DEMONSTRATIONS PRESSURED THE GOP INTO AUTHORIZING ADDITIONAL, UNPROGRAMMED IMPORTS OF CEMENT AND STRUCTURAL STEEL. BARRING AN UNLIKELY SHARP INCREASE IN OUTPUT OF THESE ITEMS, THE CONSTRUCTION SECTOR WILL BE ABLE TO EXPAND ONLY IF IT HAS ACCESS TO A LARGER VOLUME OF IMPORTS. SECOND, INITIATION OF PETROGAL'S REFINERY AT SINES, EVEN IF THE COMPANY CLOSES ITS REFINERY NEAR LISBON AND OPERATES SINES AT MINIMUM LEVELS, WILL REQUIRE INCREASED PETROLEUM IMPORTS OF ABOUT 4 MILLION TONS IN 1978. SINCE MOST OF THIS INCREMENTAL IMPORT EXCEEDS DOMESTIC REQUIREMENTS, AND SINCE PETROGAL HAS NOT YET ARRANGED FOREIGN CUSTOMERS, MUCH OF THE REFINED PRODUCTS FROM THE 4 MILLION TONS MAY SPEND 1978 IN PORTUGUESE STORAGE TANKS. HOPEFULLY PETROGAL WILL SELL THESE PRODUCTS IN 1979, THOUGH PROBABLY AT UNREMUNERATIVE PRICES. AS FAR AS THE
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1978 BALANCE OF PAYMENTS IS CONCERNED, HOWEVER, THE INCREASED PETROLEUM PURCHASES COULD ADD SOME \$200 MILLION, OR SLIGHTLY MORE THAN 4 PERCENT OF TOTAL 1977 IMPORTS, TO PORTUGAL'S FOREIGN PURCHASES WITHOUT PROVIDING AN EXPORT OFFSET. THIRD, AGRICULTURAL STOCKS OF SUCH ITEMS AS COTTON, BARLEY, VEGETABLE OILS, WHEAT, GRAIN, AND OATS ARE SUBSTANTIALLY BELOW LEVELS OF EARLY 1977. THE EXPANSION OF THE CATTLE, SWINE, AND POULTRY STOCK DURING THE PAST 18 MONTHS COMPLICATES MATTERS FURTHER IN THAT PORTUGAL DEPENDS INCREASINGLY ON IMPORTED ANIMAL FEEDS. THESE FEEDS ARE ALREADY IN SUCH SHORT SUPPLY THAT FARMERS LAST WEEKEND THREATENED TO BLOCK HIGHWAY ACCESS TO LISBON UNLESS THE GOP ALLEVIATED THEIR SUPPLY PROBLEMS. SATISFYING THE GREATER NEED FOR AGRICULTURAL PRODUCTS COULD EASILY ADD MORE THAN ONE PERCENTAGE POINT TO THE IMPORT BIL.

5. AN INVESTMENT SHIFT AWAY FROM IMPORT INTENSIVE PROJECTS MIGHT HELP REDUCE THE TRADE DEFICIT. HOWEVER, DEVELOPMENT OF ALTERNATIVE INVESTMENT PROJECTS, WITH RELATIVELY SMALL IMPORT COMPONENTS, WOULD REQUIRE CONSIDERABLE TIME. IF, IN THE MEANTIME, IMPORT INTENSIVE INVESTMENTS DECLINE, TOTAL INVESTMENT WOULD PRESUMABLY DIMINISH AND THIS LOWER INVESTMENT RATE WOULD TEND TO LIMIT 1978 GNP GROWTH.

6. UNFORTUNATELY, THE XPORT PICTURE DOES NOT APPEAR MUCH MORE ENCOURAGING. GIVEN ANTICIPATED LOW RATES OF GNP GROWTH IN PORTUGAL'S MAJOR TRADING PARTNERS, PORTUGUESE EXPORTS WILL HAVE A DIFFICULT TIME EXPANDING IN 1978. PORTUGAL'S TEXTILE INDUSTRY, THE COUNTRY'S PRINCIPAL EXCHANGE EARNER, IS ALREADY ENCOUNTERING WEAK FOREIGN DEMAND AND THREATS OF INCREASED PROTECTION ABROAD. CONFIDENTIAL

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DOMSTIC SUPPLY BOTTLENECKS, E.G., PAPER PRODUCTS AND CORK, FURTHER DAMPEN EXPORT PROSPECTS. IN EFFECT, PORTUGAL MAY NOT BE IN A POSITION TO TAKE FOREIGN MARKETS AWAY FROM ITS COMPETITORS. TO DO SO, IT MUST MARKEDLY STRENGTHEN ITS COMPETITIVE POSITION, IMPROVE ITS PRODUCTION/MARKETING SYSTEMS, AND DIVERT PRODUCTS FROM THE DOMESTIC TO THE FOREIGN MARKET.

7. THE FOREGOING PICTURE, RATHER THAN A PRESUMED FIXED IMPORT/GNP RELATIONSHIP, ACCOUNTS FOR MUCH OF OUR FEELING THAT AN \$800 MILLION CURRENT ACCOUNT DEFICIT WILL PROVE INCOMPATIBLE WITH A FOUR PERCENT GNP GROWTH IN 1978. OKUN

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